

Working Interest Ownership vs. Passive Real Estate vs. Securities

A Comparative Guide to Ownership Structure, Tax Treatment, Liquidity, and Capital Deployment Decisions Following a Business Sale, Recapitalization, or Large Distribution

Explore Working Interest Opportunities

Introduction: The 90-Day Window That Defines After-Tax Outcomes

An operator who has just closed a sale, completed a PE recapitalization, or taken a large year-end distribution faces a narrow window to make a capital allocation decision that will define after-tax outcomes for years. Three structures dominate that decision: direct working interest ownership in oil and gas production, passive real estate ownership, and public securities. Each converts a single business's concentrated equity into a different kind of asset. Each treats tax, control, and liquidity differently. None of the three is universally correct. The right choice depends on how much ordinary income or capital gain needs to be offset in the current tax year, how much operational involvement the operator wants going forward, and how much illiquidity the operator can tolerate while still meeting lifestyle and reinvestment needs.

This guide is built for a specific moment: the 90 to 180 days after a liquidity event, when surplus corporate capital, personal distribution proceeds, or recapitalization cash sits exposed to ordinary income tax, capital gains tax, or a second round of the same concentration risk the operator just tried to exit. It compares the three structures on the same criteria an investment committee or tax advisor would use, without favoring one path before the mechanics are explained.

Working Interest Ownership

Direct, undivided interest in oil and gas operations with active governance rights

Passive Real Estate

Rental real property held directly, through syndication, or a fund structure

Public Securities

Equities, bonds, index funds, and other publicly traded instruments

What Is Compared: The Three Structures Defined

Working Interest Ownership

A direct, undivided interest in the operation of a specific oil and gas property, held either directly or through an entity that does not limit the owner's liability, such as a general partnership or an unincorporated joint venture. The owner is classified as an operator under Treasury Regulation 1.612-4(a), meaning someone who holds a working or operating interest as a fee owner or under a lease or other contract granting operating rights. This is the structure Summit Ventures organizes its entrepreneurial joint venture participants into: business participants who hold a direct working interest position and retain governance rights tied to the joint operating agreement.

Passive Real Estate

Ownership of rental real property, whether directly, through a syndication, or through a fund structure, where the owner's involvement is generally limited to signing documents, reviewing distribution statements, and periodic capital calls. Most exiting operators who buy real estate as a diversification move fall into the "passive" category under IRC Section 469 because they do not meet the hours and service tests required for real estate professional status.

Public Securities

Equities, bonds, index funds, and other publicly traded instruments, whether held directly or inside a managed account. This includes the common post-exit instinct to simply park sale proceeds in a diversified portfolio of stocks and fixed income while deciding on next steps.

Six Evaluation Criteria

1. **Ownership and Control**
2. **Participation and Governance**
3. **Tax Treatment**
4. **Liquidity and Time Horizon**
5. **Concentration and Diversification**
6. **Complexity and Reporting Load**

Option A: Working Interest Ownership

A working interest places the owner directly in the chain of oil and gas operations. Intangible drilling costs, meaning the non-salvageable labor, fuel, chemicals, site preparation, and hauling costs tied to drilling a well, can be elected for current-year deduction under IRC Section 263(c) rather than capitalized over time. Tangible costs, such as casing, wellhead equipment, and tanks, are capitalized and depreciated. The portion of a given project's intangible versus tangible cost allocation depends on that specific well's engineering design, the authorization for expenditure, and the participant's own basis and at-risk position, and should always be confirmed against the project-specific AFE with a qualified CPA before any election is made.

The reason this structure can offset active income, not just passive income, traces to a separate statute: IRC Section 469(c)(3)(A), which states that passive activity "shall not include any working interest in any oil or gas property which the taxpayer holds directly or through an entity which does not limit the liability of the taxpayer." Unlike real estate's passive loss rules, there is no hours test, no material participation requirement, and no income-based phase-out tied to this exception. The deduction is tied to the classification of the activity itself, not to the owner's income level or time commitment, which is the single structural fact that differentiates this path from the other two options for a high-income exiting operator.

Key IRC Provisions

- **IRC 263(c)** — Current-year IDC election
- **IRC 469(c)(3)(A)** — Working interest exception, no hours test
- **IRC 465** — At-risk limitation on deductions
- **IRC 57(a)(2)** — AMT preference item with independent producer exception
- **IRC 611 & 613A** — Ongoing percentage depletion allowance

Two Additional Layers

IRC Section 465 limits the deduction to the participant's actual at-risk economic exposure, cash and recourse debt, not nonrecourse financing. IRC Section 57(a)(2) treats excess intangible drilling costs as an alternative minimum tax preference item only above a defined share of net oil and gas income, with an independent producer exception that further limits the AMT impact.

Once a well is producing, IRC Sections 611 and 613A permit an ongoing percentage depletion allowance on gross production income for independent producers, a benefit that continues year over year rather than expiring after a single tax cycle.

Governance in this structure runs through the joint operating agreement. Business participants receive operator reporting, well-level production data, and defined decision rights on authorizations for expenditure above stated thresholds, a materially different level of operational transparency than a fund share or a brokerage statement provides.

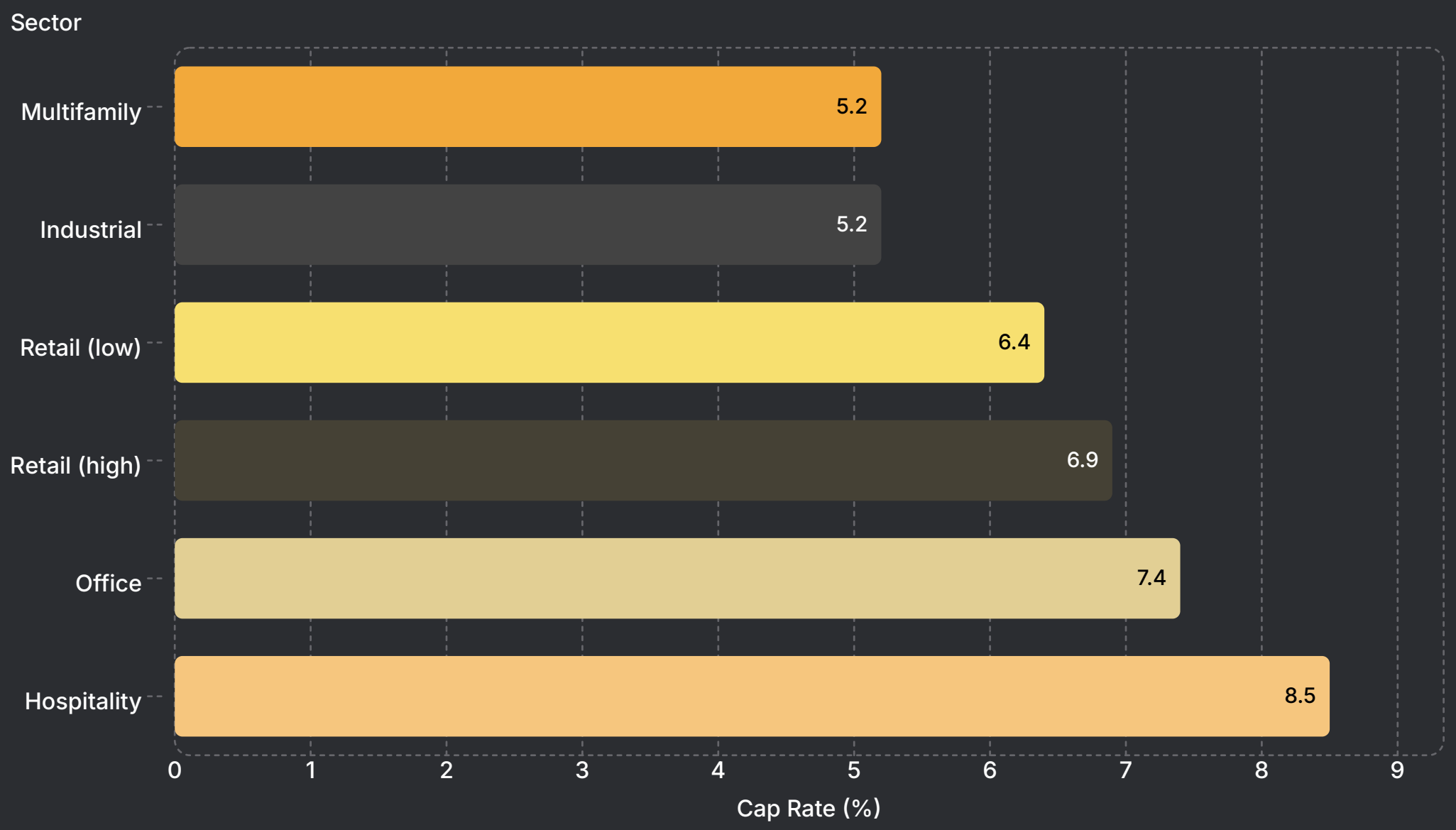
Option B: Passive Real Estate

Passive real estate ownership is the default diversification move for many exiting operators, largely because the asset class feels familiar and tangible. The tax mechanics, however, are narrower than many expect. The special $25,000 loss allowance under IRS Publication 925 phases out at 50 cents per dollar of modified adjusted gross income above $100,000 and disappears entirely at $150,000 MAGI, a threshold most exiting operators clear immediately in the year of a sale or large distribution. Reaching real estate professional status, which would remove the passive classification entirely, requires more than 750 hours of personal service in real property trades during the year and more than half of the owner's total personal service time, a standard that is structurally incompatible with someone still running or just having exited an operating business.

Depreciation remains available and bonus depreciation under IRC Section 168(k) was made permanent at 100 percent for qualifying property placed in service after January 19, 2025, under the One Big Beautiful Bill Act. On sale, the depreciation-recapture portion of any gain is taxed as unrecaptured Section 1250 gain, capped at a 25 percent federal rate, a materially higher rate than the standard long-term capital gains ceiling applied to most other asset sales.

Market conditions matter here as well. Governance in most real estate structures is limited to the sponsor's reporting cadence and whatever rights are negotiated into the operating agreement, generally less direct than a working interest's joint operating agreement framework.

2026 Commercial Cap Rates (CBRE Survey)



The CBRE 2026 Cap Rate Survey projects only 5 to 15 basis points of further compression this year, meaning current income, not price appreciation, is doing most of the work on returns.

Option C: Public Securities

Public securities, held directly or through managed accounts, offer the deepest liquidity of the three options and require no operational involvement at all. The S&P 500 has returned approximately 10 percent annually on average since 1957, according to Fidelity, a reasonable long-run benchmark, though annual results vary significantly and the figure is historical, not a forward projection.

Index Concentration Risk

Two structural issues are worth flagging for an exiting operator specifically. First, concentration has quietly returned to the index itself. RBC Wealth Management's "Great Narrowing" analysis found the ten largest S&P 500 companies represented approximately 41 percent of total index weight at the end of 2025, roughly double the concentration of a decade earlier. An operator diversifying out of one concentrated position can end up with meaningful concentration inside what looks like a diversified index fund.

C-Corporation Double Taxation

For operators who hold or receive proceeds through a C-corporation, dividend income faces two layers of tax: the 21 percent corporate rate at the entity level, followed by qualified dividend tax up to 20 percent plus the 3.8 percent net investment income tax, for an effective combined rate approaching 23.8 percent on qualified dividends and considerably higher on non-qualified dividend income, before any state tax.

Securities carry no current-year deduction mechanism tied to the exiting operator's ordinary income or the proceeds of the sale itself. Any tax efficiency comes from asset location, holding period, and loss harvesting rather than a current-year statutory election. Governance is limited to voting rights on shares held directly, with no operational input into the underlying businesses.

10%

S&P 500 Avg. Annual Return

Historical average since 1957 (Fidelity)

41%

Top 10 Index Concentration

S&P 500 top ten holdings at year-end 2025 (RBC)

23.8%

Effective Dividend Rate

Combined C-corp qualified dividend effective rate

Side-by-Side Comparison

The table below compares all three structures across the six criteria that matter most to an exiting operator evaluating where to place concentrated post-exit capital.

Category	Working Interest	Passive Real Estate	Public Securities
Ownership & Control	Direct title to working interest; governance rights under joint operating agreement	Direct title or syndication/fund share; governance limited to sponsor-negotiated rights	Shares or units in publicly traded instrument; governance limited to voting rights
Participation & Governance	Operator reporting, well-level production data, AFE-based decision rights; active JV member status	Periodic sponsor reporting and capital call notices; limited day-to-day input	No operational participation; quarterly filings and proxy votes only
Tax Treatment	Current-year IDC election under IRC 263(c) against active income; no hours test or income phase-out; ongoing 611/613A depletion	$25,000 allowance phased out $100K–$150K MAGI; 750+ hours for professional status; 25% unrecaptured 1250 gain on sale	No current-year deduction; long-term capital gains on sale; C-corp dividends subject to double taxation up to 23.8% effective rate
Liquidity & Time Horizon	Illiquid by design; return tied to producing life of asset and operator distributions	Illiquid; typical hold periods measured in years; exit tied to sale or refinance timing	Highly liquid; can generally be converted to cash within a trading day
Concentration & Diversification	Diversifies into a physically distinct asset class and geography	Diversifies asset class but can concentrate by geography or sponsor	Diversifies by instrument but top ten S&P 500 holdings near 41% of index weight
Complexity & Reporting	AFE review, K-1 reporting, CPA coordination on IDC, at-risk, and AMT treatment	K-1 or Schedule E reporting, hours tracking if pursuing professional status, depreciation schedules	Lowest administrative load; standard 1099 reporting and brokerage statements

Advantages, Limitations, and Best-Fit Scenarios



Working Interest: Advantages & Limitations

Working interest ownership offers the clearest current-year tax mechanism tied directly to the activity's classification rather than the owner's income level, along with direct governance visibility into how capital is deployed. Its primary limitation is illiquidity and the operational nature of the underlying asset, which requires comfort with AFE-based decision-making and reliance on an operator's execution.

Best fit: Operators with a defined, current-year tax liability from an asset sale, recapitalization, or large distribution who want a direct, governed participation structure rather than a fund they do not control. Also fits operators comfortable evaluating AFEs and production reports the way they once evaluated their own business's operating metrics.



Passive Real Estate: Advantages & Limitations

Passive real estate offers a familiar asset class and durable depreciation benefits, but its passive-loss limitations phase out almost immediately for operators coming off a liquidity event, and reaching full real estate professional status is rarely compatible with running or having just exited an operating business.

Best fit: Operators with a longer runway before needing liquidity, who are not facing an immediate large ordinary-income event this tax year, and who want a tangible asset class with a long track record among business owners.



Public Securities: Advantages & Limitations

Public securities offer liquidity and simplicity that neither other option can match, but provide no current-year offset to ordinary income or sale proceeds, expose the owner to double taxation inside a C-corporation structure, and have quietly reconcentrated at the index level even for investors seeking diversification.

Best fit: The portion of post-exit proceeds earmarked for near-term liquidity needs, such as a reserve for living expenses or near-term reinvestment into a new venture, where access to capital within days matters more than any current-year tax mechanism.

Decision Guidance & Questions for Professional Advisors

Most exiting operators do not choose only one of these three paths. The more common pattern is a deliberate allocation: a liquidity reserve in public securities, a longer-horizon real estate position for operators with the runway to use it, and a working interest allocation sized specifically to the current-year ordinary income or gain that needs an offset. Summit Ventures works with exiting and post-exit operators specifically on that third allocation, structuring the capital contribution and AFE review so the participant understands exactly what portion of the contribution is expected to be IDC-eligible before the election is made, and maintaining the governance reporting a former operator expects from any asset they hold a direct interest in.



Liquidity Reserve

Public securities for near-term needs

Real Estate Position

Longer-horizon allocation for operators

Working Interest

Sized to current-year tax offset

Questions to Bring to Your Professional Advisors

1. Does the timing of my liquidity event mean the $25,000 real estate allowance will already be fully phased out in the year I would need the deduction most?
2. What is my current at-risk basis under IRC 465, and how does that interact with any IDC election I am evaluating?
3. How does IRC 57(a)(2) affect my alternative minimum tax exposure given my specific income mix this year?
4. If I hold a working interest through an entity, does that entity's structure preserve or forfeit the IRC 469(c)(3)(A) exception?
5. What portion of my post-exit proceeds genuinely needs same-week liquidity versus a multi-year horizon?
6. How concentrated is my current securities allocation at the index level, not just at the account level?
7. If I am distributing proceeds through a C-corporation, what is my actual effective rate after both layers of dividend tax?
8. What governance rights, reporting cadence, and AFE review process should I expect before committing capital to any working interest position?

Closing Perspective

> The decision between working interest ownership, passive real estate, and public securities is not a search for a single winning asset class. It is a capital allocation exercise built around the specific tax exposure, time horizon, and governance preferences an exiting operator has in the months after a liquidity event.

Working interest ownership is the only one of the three structures where the tax mechanism attaches to the classification of the activity itself rather than to income level or hours worked, which is why it is frequently sized to address the current-year tax liability directly, while real estate and securities continue to serve their own roles in the broader allocation. Reviewing the specific AFE, entity structure, and at-risk position with a qualified CPA before any capital is committed remains the step that determines whether the intended tax treatment is actually achieved.

Sources and References

26 CFR 1.612-4(a), Treasury Regulations, operator definition under IRC Section 263(c). | 26 U.S.C. Section 469(c)(3)(A), Cornell Legal Information Institute, working interest exception statutory text. | 26 U.S.C. Section 465, at-risk limitation. | 26 U.S.C. Section 57(a)(2), alternative minimum tax preference for excess intangible drilling costs, independent producer exception.

26 U.S.C. Sections 611 and 613A, percentage depletion allowance for independent producers. | IRS Publication 925, Passive Activity and At-Risk Rules, special $25,000 allowance phase-out, $100,000 to $150,000 MAGI. | IRC Section 168(k), One Big Beautiful Bill Act, permanent 100 percent bonus depreciation for property placed in service after January 19, 2025, Grant Thornton 2025 legislative alert. | Thomson Reuters, unrecaptured Section 1250 gain, 25 percent federal rate cap on depreciation recapture.

CBRE 2026 Cap Rate Survey and Market Outlook, commercial real estate cap rate ranges and projected compression. | Fidelity, historical S&P 500 average annual return since 1957. | RBC Wealth Management, "The Great Narrowing," S&P 500 top ten index concentration analysis, year-end 2025. | legalclarity.org, C-corporation double taxation mechanics on dividend distributions. | U.S. Energy Information Administration, Short-Term Energy Outlook, 2026 record domestic crude production forecast. | American Petroleum Institute, "Industry Explained," oil and gas sector jobs and economic contribution figures.

This guide is for informational purposes only and does not constitute tax, legal, or investment advice. Always consult a qualified CPA and legal advisor before making any capital allocation or tax election decision.

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